



STATE BOARD OF EQUALIZATION STAFF LEGISLATIVE BILL ANALYSIS

Date Amended:	03/24/08	Bill No:	AB 2240
Tax:	Fuels	Author:	Tran and Price
Related Bills:			

BILL SUMMARY

This bill intends to provide an excise tax exemption for biodiesel fuel produced from California feedstock in this state.

ANALYSIS

CURRENT LAW

Under the current Diesel Fuel Tax Law (Part 31 (commencing with Section 60001) of Division 2 of the Revenue and Taxation Code), Section 60022 defines “diesel fuel” as any liquid that is commonly or commercially known or sold as a fuel that is suitable for use in a diesel-powered highway vehicle, including biodiesel. A liquid meets this requirement if, without further processing or blending, the liquid has practical and commercial fitness for use in the engine of a diesel-powered highway vehicle. Additionally, Section 60023 defines “blended diesel fuel” to mean any mixture of diesel fuel with respect to which tax has been imposed and any other liquid on which tax has not been imposed. “Blended diesel fuel” also means any conversion of a liquid into diesel fuel. “Conversion of a liquid into diesel fuel” occurs when any liquid that is not included in the definition of diesel fuel and that is outside the bulk transfer/terminal system is sold as diesel fuel, delivered as diesel fuel, or represented to be diesel fuel. This definition is purposely broad so that any fuel suitable to be used in a diesel-powered highway vehicle would be subject to the excise tax.

Under the Diesel Fuel Tax Law (Part 31 (commencing with Section 60001) of Division 2 of the Revenue and Taxation Code), the state imposes an excise tax of \$0.18 per gallon on diesel fuel. Biodiesel fuel is taxed in the same manner as traditional diesel. In that regard, the state imposes the excise tax at the first point at which the biodiesel fuel is either:

- Imported into California for sale, use, or storage,
- Removed from a California refinery,
- Removed from a terminal rack in California, or
- Blended with tax-paid diesel fuel.

The \$0.18 state excise tax, however, is excluded from the computation of sales tax.

Under the **Use Fuel Tax Law** (Part 3 (commencing with Section 8601) of Division 2 of the Revenue and Taxation Code) the state imposes an excise tax at a rate of \$0.18 per gallon on the sale or use of any combustible gas or liquid (such as kerosene) of a kind used to propel a motor vehicle on the highways of this state that is not taxed as motor vehicle fuel or diesel fuel. The state also imposes an excise tax on the following use

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fuels: liquefied petroleum gas at a rate of \$0.06 per gallon; compressed natural gas at a rate of \$0.07 per 100 cubic feet; liquid natural gas at a rate of \$0.06 per gallon; ethanol at a rate of \$0.09 per gallon; and methanol at a rate of \$0.09 per gallon.

The revenues generated from these excise taxes are deposited in the Transportation Tax Fund.

PROPOSED LAW

This bill would add Section 8651.4 of the Revenue and Taxation Code to provide an exemption from the Use Fuel Tax for biodiesel produced in this state with California feedstock. Additionally, the California Energy Commission and the Board would cooperate to oversee the tax incentive program and produce an annual report to the Legislature regarding the excise tax exemption. The report would be posted on the Energy Commission's website and would include the following:

- The effect of the tax incentive program on the consumption of biodiesel by consumers.
- Economic benefits or losses to the state as the result of the program.
- Calculation of greenhouse gas emission reductions.

This act would become effective immediately, but operative between January 1, 2009 and before January 1, 2014. The act is repealed December 1, 2014.

IN GENERAL

Biodiesel is a renewable diesel fuel replacement that is manufactured from domestically produced oils such as soybean oil, recycled cooking oils, or animal fats. These fats and oils, also called triglycerides, are chemically reacted with a short chain alcohol (such as methanol) and a base catalyst, such as sodium hydroxide, in a process called transesterification. Biodiesel and a glycerin co-product are produced from this process. Biodiesel can be used alone (B100) or blended with petroleum diesel in any proportion. The most popular biodiesel blends are B99, B20, or B5. Any diesel engine can operate on these blends with few or no modifications.

Biodiesel, unlike most other fuels, is not separately defined in the Revenue and Taxation Code or the Business and Professions Code (Article 1 of Chapter 14 of Division 5). Those relevant sections in the Business and Professions Code regarding transportation fuels are related to the administrative responsibilities of the Department of Food and Agriculture, Division of Measurement Standards. This division is responsible for enforcing the quality, advertisement, and labeling standards for most petroleum products offered for sale to the public. As biodiesel is considered a developmental engine fuel, as determined by the Department of Food and Agriculture, it is required to meet the specifications in Regulation 4147 of the California Code of Regulations, Division 9, Chapter 6. This regulation, which covers the biodiesel blending stock and biodiesel fuel blends, specifies that these fuels meet the standards set by the American Society for Testing and Materials (ASTM D 975 and ASTM D 6751).

COMMENTS

- 1. Sponsor and Purpose.** According to the author's office, this bill is sponsored by the California Biodiesel Alliance to encourage the production and use of biodiesel in California.

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2. **Biodiesel is taxed under the Diesel Fuel Tax Law.** The bill currently exempts biodiesel fuel under the Use Fuel Tax Law. This should be amended to correct the tax law and tax section reference. If the author's intent is to provide a more general exemption for non-petroleum fuels, or even biofuels, then the author should make appropriate clarifications and amendments. Board staff is available to work with the author's office in drafting appropriate amendments.
3. **Assuming the bill is amended to reference the Diesel Fuel Tax Law, what kind of biodiesel would be exempt from the excise tax?** The proposed exemption would only apply to biodiesel that is produced in California from "California feedstock." The term "feedstock" is commonly defined as the raw material required for an industrial process. The most commonly used feedstock that produces fats and oils, or triglycerides, necessary for biodiesel production is soybean oil, but other vegetable oils, such as corn, cottonseed, canola, flax, sunflower and peanut, are also used. Another source of triglycerides is the recycled oil and grease generated from restaurants and food processing plants. An alternative feedstock used for biodiesel production comes from animal-derived products, such as tallow, choice white grease (lard), poultry fat, and yellow grease (lower-quality grade of tallow).

Could the other components of the transesterification process, the short-chain alcohol and the base catalyst, also be considered "feedstock"? In the case of vegetable oils, would the oil or the actual plant need to be derived from California? What if a California company extracts the oil in this state from "Midwest" soybeans? Would the resulting oil be considered "California feedstock"? In the case of animal-derived oils and fats, would the animal need to be native to California? Could the oil and fat be rendered from a "Midwest" animal in California and still be considered "California feedstock"? In the case of recycled oil or grease, would the grease need to have first been used in California, or only recycled by a California company?

Whose responsibility will it be to determine the feedstock origination? This bill proposes to amend the Revenue and Taxation Code but makes no additions to the Business and Professions Code to define biodiesel. The Board does not have the resources, expertise, or staff, much less the administrative responsibility, to enforce the quality, advertisement, and labeling of biodiesel fuels. Without specific definitions for "biodiesel" and "California feedstock" the Board may also not be able to audit the validity of claimed exemptions.

Moreover, even if a definition is provided in the Business and Professions Code, the Division of Measurement Standards would only regulate those fuels offered for sale to the public and would not affect certain biodiesel users, such as those individuals and producers that recycle used cooking oil for their own self-consumption.

4. **How would the Board identify the biodiesel fuel produced in California from California feedstock?** Currently, the Board does not separately categorize biodiesel produced in this state from California feedstock. Although the Board has the ability to identify large producers of biodiesel in California, we would need to develop product listings for biodiesel so that those considered to be from "California feedstock" would be exempt from the state's excise tax. The Board would be challenged in identifying individuals that produce the qualified biodiesel. Therefore, we may only be able to provide limited sales and revenue information to the Energy Commission for preparation of the annual report to the Legislature.

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- 5. Reporting requirements would be complicated.** Only that portion of the biodiesel fuel that is produced in this state from California feedstock would be subject to the exemption from the diesel fuel tax. As such, the terminal operator, supplier, retailer, and consumer may see differing tax rates and prices depending on the biodiesel fuel blend or source of the biodiesel fuel. Invoicing and receipt requirements may also need to be changed to show that the exempt portion of the blended diesel was not taxed.

Currently, California does not offer tax breaks or incentives for diesel blended with biodiesel. The diesel blend, regardless of concentration, is considered diesel fuel when sold for use in a diesel powered highway vehicle.

Reporting requirements could be more complicated for all parties involved since blending of biodiesel can occur at different points in the distribution process. Blending of the diesel and biodiesel could occur at the user's gas tank, at the supplier's tanker trucks, or the terminal operator's pipeline or rack. If a previously untaxed biodiesel, not produced or derived from California feedstock, is mixed with diesel, then the portion of the biodiesel subject to tax is the difference between the total volume and the amount previously taxed.

- 6. This bill could make reporting for interstate users more difficult.** Interstate users would be burdened with additional record keeping and segregating for purposes of reporting the correct amount of tax on purchases of biodiesel produced in California from California feedstock. While California may exempt the biodiesel produced in this state from California feedstock, without invoices or receipts showing the reduced taxes it would be difficult for the interstate user to document a credit. In addition, other jurisdictions in which the interstate user travels and reports and pays tax may not allow such credits even with an invoice. Accordingly, this bill could complicate reporting for interstate users and could lead to additional reporting errors.
- 7. A delayed operative date would allow time for the Board to prepare for a substantial change.** As specified in the bill, the exemption for biodiesel fuels could go into effect as soon as January 1, 2009. In general, the Board would need to prepare regulations, revise tax returns and publications, notify affected parties, and create programs to track the new product codes. Board staff is available to work with the author's office in suggesting an appropriate operative date.

COST ESTIMATE

As currently written, there would be no exemption for the specified biodiesel under the Use Fuel Tax Law and therefore no costs to the Board. However, the Board would incur costs related to the administration of a biodiesel exemption, as contemplated by this act, under the Diesel Fuel Tax Law. These costs would be attributable to, among other things, identifying and notifying qualifying entities, auditing claimed amounts, revising diesel fuel tax returns, and programming changes.

REVENUE ESTIMATE

The bill currently provides an exemption for the specified biodiesel under the Use Fuel Tax Law, and as such there would be no revenue loss attributable to this exemption. In addition, it is not possible at this time to identify which biodiesel fuel would actually be exempt, given the current definitions. However, if appropriate amendments are made, the amount of qualifying exempt fuel could be obtained from the following sales and consumption amounts.

The Board's Fuel Taxes Division indicated that in 2006, suppliers reported 36 million gallons of biodiesel fuel (25 million gallons clear, 11 million gallons dyed) and that this would account for most commercially produced or imported biodiesel diesel. In our discussions with the Energy Commission, they estimated that California biodiesel consumption in 2006 was 43 million gallons. This difference is probably due to tracking fuel in different ways for different purposes. Estimated consumption for 2007 is 100 million gallons.

The Energy Commission provided the following estimate for the period January 1, 2009 to January 1, 2014:

California Biodiesel Consumption Estimate 2009-2013 (millions of gallons)

	In State Production	Imported to CA	Total CA Demand
2009	180	120	300
2010	240	150	390
2011	300	175	475
2012	360	200	560
2013	420	200	<u>620</u>
			2345

(Due to the volatility of the market, these estimates frequently change.)

Based on the above five-year period, average annual biodiesel fuel consumption is estimated to be 469 million gallons (2345 / 5), which translates into \$84.4 million in excise taxes (\$0.18 x 469 million gallons = \$84.4 million).

The exemption intended to be created by this bill would be an as yet undeterminable percentage of that total revenue.

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